

Liquidity without Liquidation

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We examine whether tax-aware equity strategies can provide meaningful liquidity without full liquidation or material impairment of their investment objectives. We find that substantial capital can be withdrawn while preserving tracking error, leverage, and pre-tax information ratios. Tax-efficient withdrawal capacity is generally greater for long-short strategies than for direct indexing and increases with the strategy's tracking error and leverage. An optimized withdrawal process can adapt withdrawal amounts to the strategy's capacity to offset withdrawal-related realized gains with realized losses, given the strategy's age and the prevailing market environment. Partial withdrawals can provide substantial tax-efficient liquidity while preserving the economic characteristics of the remaining portfolio and, in some scenarios, its ability to continue realizing net capital losses. Liquidity without liquidation is therefore an important dimension of the flexibility of tax-aware long-short investing.

This document is not intended to, and does not relate specifically to any investment strategy or product that AQR offers. It is being provided merely to provide a framework to assist in the implementation of an investor's own analysis and an investor's own view on the topic discussed herein.

Source: <https://www.aqr.com/Insights/Research/Working-Paper/Liquidity-without-Liquidation>